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NON PROFIT HMO'S & THE HEALTH CARE CRISIS

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INTERIM REPORT

The Office of the Secretary of the Commonwealth reviewed the corporate organizations, policies and procedures of three HMOs operating in the Commonwealth, Harvard Pilgrim Health Care Inc. ("Harvard"), Fallon Community Health Plan ("Fallon"), and Tufts Associated Health Maintenance Organization ("Tufts"). Each of these HMO is registered with the Secretary of the Commonwealth as a non-profit corporation under M.G.L. c. 180. None of the entities has organized consistent with M.G.L. 176G, the Chapter of Massachusetts Law specifically designed for HMO. As non-profits they are potentially exempt from all state and local taxes even if they own for-profit subsidiaries.

All non-profit corporations share four general characteristics: (1) they are all designated non-profit when they are incorporated; (2) all such organizations must affirmatively prove that that no part of any assets or interest inure to the benefits of its members, directors, or officers or any person or for- profit corporate entities or firm operating for profit; (3) they lawfully pursue only such purposes as set forth in §4 of c. 180; and (4) all non-profits must act consistently with the stated purpose in their corporate charters and cannot engage in activities that are beyond their approved purposes or are ultra vires. The purpose of this review and study, therefore, was to ascertain whether the HMOs were providing a public benefit and maintaining the requirements of non-profit status.

Among the materials reviewed were the HMOs' corporate filings made with the Division of Insurance as well as filings made with the Attorney General's Division of Public Charities. Finally, a letter of inquiry was forwarded to each HMO requesting information and clarification of information gleaned from corporate filings. An overview of the concerns raised and the HMOs' responses to date is set forth below.

Interlocking Directors

Each organization reviewed had an excessively complex corporate structure consisting of a myriad of affiliated and related entities. Within each HMO organization there exists both for profit and non-profit corporate entities. Of particular concern in this regard is the interlocking relationships that exists between these profit and non-profit corporations, with directors of non-profit corporate entities also sitting as directors of for profit corporate affiliates.

In response to questions concerning these interlocking directorships both Tufts and Harvard provided lists of officers and directors. Tufts and Harvard confirmed in their respective filings that the interlocking directorates continue to exist. Fallon failed to respond to this request for this information.

Clearly the corporate mission, objectives, and goals of non-profit corporations can be at odds with those of for profit corporations. A director who has a fiduciary duty to serve both can find him or herself in the untenable situation of having to serve two masters with conflicting needs. For example in the Tufts' corporate structure, the non-profit HMO contracts with the for profit corporate health plan organization for provisions of management, personnel and other services. Five members of the Board of Directors of the HMO are also members of the health organization. Obviously, this arrangement is replete with conflicting corporate objectives and needs.

Among the documents and materials requested were the HMO's submit their written policies and/or procedures to address these potential conflicts. None of the HMOs had any written policies and/or procedures in place. Without such proactive measures, there are no guarantees that the interest of the non-profit HMOs will not being subjugated to those of the for profit entities.

Loans and Material Transactions

Each HMO was asked a series of questions concerning loans and other material affiliated transactions between the non-profit HMO and their for profit affiliated entities. The purpose of this line of inquiry was to determine whether such transactions were consistent with the HMO's corporate charter resolution that no part of their earnings benefits any member, director or private individual.

In 1998, Tufts paid approximately $90 million to an affiliated for profit corporation as a management fee and $13 million to a for profit subsidiary as an administrative fee. While Tufts failed to provide the requested contracts, their response definitively established that the contracts did not go out to bid to an unaffiliated management firm. In addition, Tufts confirmed that an outside independent expert was not required to opine as to the reasonableness of the fee or determine that fees paid by the non-profit to the affiliated for profit corporation are on terms no less favorable to the non-profit HMO than the fee it would pay an unaffiliated third party to provide these services.

In Fallon's Division of Insurance Annual Statement for fiscal year ended December 31, 1998, it stated that Fallon made a $3,000,000 loan to Fallon Clinic. Tangible evidence was requested that the loan was negotiated on terms no less fair to Fallon as those which could be obtained from an unrelated entity. Also asked were the following questions concerning this loan: (1) the purpose of the loan; (2) why Fallon Clinic did not obtain the loan from an unrelated entity; and (3) the legal authority or corporate charter provision authorizing Fallon to make this loan. Fallon has thus far failed to provide any meaningful response to a business structure that raises serious concerns about actual conflicts of interest between the entities.

Charitable Contributions

The HMOs, reviewed by this Office, each made the conscious decision to establish

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themselves as non-profit charities in order to reap the benefits of both tax-exempt status and limited liability. It was with some degree of surprise, therefore, to find that the HMOs were less than forthcoming in responding to questions concerning the HMO's charitable contribution. For example, Harvard rather than responding directly to the questions, merely made reference to its filing with the Attorney Generals Office. Tufts and Harvard each failed to definitively disclose whether there was any affiliation between any officer and director of the HMO and the recipient of a charitable donation.

This inquiry centers around potential conflicts of interest between non-profit and for profit companies and whether an individual or entity is profiting from that arrangement. Information relating to connection between individuals at the HMO and recipients of charitable funds is vital to further investigating the appearance of significant conflicts of interest.

Senior Prescription Coverage

A number of questions were raised concerning each HMO's decision to eliminate prescription drug coverage for the elderly. The basis for the questions stemmed from the apparent conflict between the HMO's charitable objective and its business decision to increase profitability by eliminating a necessity of life for the elderly.

It was requested of each HMO that they submit any and all internal memorandum and/or board minutes of the HMO and/or any other affiliated corporate entity, in which the issue of the termination of unlimited prescription drug coverage for senior citizens was recommended or discussed.

All three HMO refused to submit this information for review.

RECOMMENDATIONS

1. A new form of regulatory review of health insurer conduct, particularly substantive changes in the quality of service must be implemented immediately. To make it more analogous to monopoly regulation. The authority of M.G.L. Chapter 176G to regulate the conduct of HMO's must be strengthened and the vigorously enforced.

2. In retail pharmacies the wholesale price of all prescription drugs and the actual contribution of insurers to the payment of retail costs should be disclosed at the time of purchase.

3. Massachusetts should use its existing regulatory power over retail and wholesale pharmacies to create annual profiles of prescription drug needs and price structure within the Commonwealth.

4. The Commissioner of Insurance should immediately re-open enrollment for Medigap insurance for HMO members who have been denied access to physicians because of the cancellation of physician contracts with HMO's.

5. The Secretary's Division of Corporations will continue to scrutinize the corporate filing of health care providers for compliance with state law.

6. The Office of the Secretary will work with the newly established task force of the Boston Bar Association on Chapter 180 to reform existing non-profit laws.

CONCLUSION

Sufficient evidence exists to conclude that in the conduct of their business all three HMO's may have engaged in activities in conflict with their non-profit status. Nevertheless, it is the Secretary's determination that proceeding to a full formal hearing under M.G.L. 30A would not be in the best interest of the citizens of the Commonwealth at this time.

The Secretary has concluded that at this time there is an emerging health insurance crisis in Massachusetts, especially in the treatment of elderly HMO patients, which supersedes the narrower issue of inappropriate corporate behavior. The health insurance system is falling apart, instead of managed care, our system in Massachusetts largely provides only managed costs with diminishing care at higher premiums. As employers react to higher premiums it is likely that even more citizens of all ages will feel the effects of this crisis.

This investigation began largely as a result of the non-profit HMO behavior earlier this year in restricting access to prescription drugs for Medicare members. During this year, however, HMO coverage has continued to deteriorate with the departure of many physicians from various plans. At the same time, these HMO's have continued their vigorous competition using paid advertising to compete for members.

Massachusetts has traditionally led the nation in providing quality health care to its citizens and being innovative in both treatments and methods of delivery of care. The present system is falling woefully short and endangering the lives of its citizens. Comprehensive action must come now. It is time to recognize that health care involves human lives and unrestricted change in basic service is not appropriate. It is ironic that Massachusetts consumers have more governmental recourse if their utility service is interrupted than they do at this time if their health care services are terminated.